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In the Supreme Court of the United States

OCTOBER TERM, 1966

No.

GOVERNMENT OF GUAM, PETITIONER

v.

ATKINS-KROLL (GUAM) LTD., A CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of the Government of Guam, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The memorandum of law and judgment of the distict court (Appendix A, *infra,* p. 17) are not officially reported. The opinion of the court of appeals (Appendix A, *infra,* p. 19) is reported at 367 F. 2d 127.

JURISDICTION

The judgment of the court of appeals was entered on September 30, 1966 (Appendix A, *infra,* p. 25). On December 22, 1966, Mr. Justice Brennan extended

the time for filing a petition for a writ of certiorari to and including February 27, 1967. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

The Guam Territorial income tax law imposes a tax of 30 percent on dividends, interest, salaries, and other types of income paid by a Guamanian corporation to a "foreign corporation." The question presented is whether a corporation incorporated in the United States is "foreign" and thus subject to this tax.

STATUTES INVOLVED

The pertinent provisions of the Organic Act of Guam and the Internal Revenue Code of 1954 are printed in Appendix B, *infra*, pp. 26–31.

STATEMENT

Atkins-Kroll (Guam), Ltd. ("A.K. Guam") is a Guam corporation doing business in Guam. All of its capital stock (except qualifying shares) is owned by a California corporation, Atkins, Kroll and Company, Ltd. ("A.K. California"), which is not engaged in business in Guam. In 1958, A.K. Guam declared and paid to its parent, A.K. California, a cash dividend of $25,000. The Guam Territorial income tax law—which is patterned on the United States Internal Revenue Code—imposes a tax on a foreign corporation not engaged in business in Guam which receives dividends, interest, wages, etc., from a domestic corporation. The tax is 30 percent of the gross amount of the dividends, interest, wages, etc. and, because of the difficulty of collecting this tax from a foreign

corporation, the statute requires the Guamanian payor to withhold and remit the tax to the Government of Guam.[1]

Guam asserted that since A.K. Guam, a domestic corporation, had paid a $25,000 dividend to a foreign corporation, A.K. California, in 1958, A.K. California was liable for a tax of $7,500 (30 percent of $25,000); and that A.K. Guam, the payor, was therefore liable for the tax because it was required to withhold and remit to the Government of Guam 30 percent of the dividend paid. A.K. Guam paid the $7,500 tax and instituted this suit for a refund.

The district court held that for purposes of the Guam income tax a California corporation is a "foreign corporation" and thus that the dividends paid by A.K. Guam to A.K. California were paid to a foreign corporation. It therefore denied the claimed tax refund. (App. A, *infra*, pp. 17–19.) The court of appeals reversed, holding that A.K. California is a domestic rather than a foreign corporation for purposes of this provision of the Guam income tax. The court of appeals reasoned that if A.K. California were a foreign corporation subject to the 30 percent tax, Guam would collect more than 50 percent in tax on the same item of income, *i.e.*, it would collect the usual corporate tax of approximately 50 percent from A.K. Guam when it earned the income and another tax of 30 percent from A.K. California when it received A.K. Guam's after-tax earnings as a dividend, a com-

[1] See Organic Act of Guam, § 31; Internal Revenue Code of 1954, §§ 881, 1442, (App. B, *infra*, pp. 26–27); §§ 1461, 1462.

bined tax of approximately 65 percent. (App. A, *infra*, pp. 19–24.)

REASONS FOR GRANTING THE WRIT

The court of appeals held that, for purposes of the tax which the Guam revenue legislation imposes upon dividends, interest, etc. received by "foreign" corporations from Guamanian corporations, an American corporation doing no business in Guam is a "domestic" rather than a "foreign" corporation. The decision is important to the administration of the Guam Territorial income tax since it deprives Guam of the revenue produced by the 30 percent tax on dividends and other payments to United States corporations.[2] In addition, the decision is likely to have an unsettling effect upon the administration of the substantially identical provisions of the Virgin Islands income tax law.[3]

Guam has a mirror income tax, that is, the income tax laws (including the rates of tax) in force in the United States from time to time constitute the income tax laws of Guam and impose a separate tax payable

[2] Moreover, whether a corporation is domestic or foreign is basic to the entire Guam taxing system. This is true not only for the Code sections discussed *infra*, but also for a great variety of other Code provisions. See, *e.g.*, §§ 243(d), 245, 301(b)(1)(C), 367, 902, 951–964, 1246–1248, 1504(b)(3).

[3] The Virgin Islands, like Guam, has a mirror income tax patterned on the United States Internal Revenue Code. Naval Service Appropriations Act of July 12, 1921, c. 44, 42 Stat. 122, 123, § 1 (48 U.S.C., § 1397); see *Dudley* v. *Commissioner*, 258 F. 2d 182 (C.A. 3); I.T. 2946, XIV–2 Cum. Bull. 109 (1935); I.T. 3690, 1944 Cum. Bull. 164.

to the Government of Guam.[4] Congress accomplished this by providing that: "[E]xcept where it is manifestly otherwise required, the applicable provisions of the Internal Revenue Codes of 1954 and 1939, shall be read so as to substitute 'Guam' for 'United States' * * * and with other changes in * * * language, including the omission of inapplicable language, where necessary to effect the intent of this section." Organic Act of Guam, § 31(e) (App. B, *infra*, p. 29).

The decision below violates the basic premise on which Guam's corporate tax law is based, *i.e.*, that Guam and the United States are separate and distinct taxing jurisdictions,[5] so that Guam corporations are "foreign" for purposes of the United States income tax and United States corporations are "foreign" for purposes of the Guam tax.[6] Moreover, the court's reasoning ignores the equally fundamental concept that a corporation and its shareholders are separate taxable entities, so that income may be taxed once when earned by the corporation and again when received by the stockholders. Since appellate review of deci-

[4] Organic Act of Guam, § 31(b), as amended in 1958 (App. B, *infra*, p. 28). Although the 1958 Amendment clarified the Guam law, it is both declaratory of the preexisting law and retroactive. See Organic Act of Guam, § 31(d)(1) (App. B, *infra*, p. 28); *Laguana* v. *Ansell*, 102 F. Supp. 919 (D. Guam) (legislative history of § 31), affirmed *per curiam*, 212 F. 2d 207 (C.A. 9), certiorari denied, 348 U.S. 830; *Jennings* v. *United States*, 168 F. Supp. 781 (Ct. Cl.), vacating opinion, 155 F. Supp. 571; I.T. 4046, 1951-1 Cum. Bull. 57.

[5] Organic Act of Guam, § 31(b) (App. B, *infra*, p. 28) and authorities cited *supra*, fn. 4.

[6] It is clear that for purposes of the United States tax Guam corporations are foreign. See *infra*, p. 7.

sions of the Guamanian taxing authorities may be had only in the Court of Appeals for the Ninth Circuit, there is no possibility of a conflict of decisions developing between the circuits. In view of both the importance of the question and the error of the court of appeals, review by this Court is warranted.

The issue in the present case requires (1) an explanation of the relevant sections of the Internal Revenue Code of 1954 as they operate in the United States and (2) an analysis of the substitutions and changes in the language of the Code that are necessary in order to convert these provisions of United States tax law into the Guam Territorial income tax.

1. Section 11 of the Internal Revenue Code of 1954 imposes a tax of approximately 50 percent on the taxable income of "every corporation."[7] Read literally this section would tax the world-wide net income of "every corporation," domestic or foreign, regardless of whether it had any contact with the United States. Domestic corporations are, in fact, taxed by the United States on their world-wide net income. However, §§881 and 882 provide special treatment for "foreign corporations." Section 881 exempts from the general §11 tax all foreign corporations not engaged in business in the United States and imposes upon them instead a tax of 30 percent of certain gross income (such as dividends and interest) received by them from United States sources. This tax is to be withheld and remitted to the federal government by

[7] The tax has varied in recent years around the 50 percent level, and for purposes of this petition we will use the figure 50 percent.

the United States payor of the income. 1954 Code §§1442, 1461, 1462. Section 882 provides that foreign corporations engaged in business in the United States are taxable under §11, but only on their net income from sources within the United States.[8]

Thus it is important to determine whether a corporation is "domestic" or "foreign," since a domestic corporation pays a tax of approximately 50 percent upon its world-wide net income, a foreign corporation engaged in business in the United States pays a tax of approximately 50 percent on its United States source net income, and a foreign corporation not engaged in business in the United States pays a tax of 30 percent on certain types of its United States source gross income (including dividends received from a United States corporation). A domestic corporation is one "created or organized in the United States or under the law of the United States or of any State or Territory"; all other corporations are foreign. 1954 Code § 7701(a)(4), (5). For this purpose, only Alaska and Hawaii were, before they attained Statehood, considered Territories; Guam is considered a possession,[9] and its corporations are thus foreign, for purposes of the United States income tax.[10]

2(a). We now show how the relevant provisions of the 1954 Code should be converted into the Guam Ter-

[8] The Foreign Investors Tax Act of 1966, P.L. 89-809, Section 104, 80 Stat. 1539, 1555-1557, altered the language of 1954 Code §§ 11, 881 and 882 in some respects without significantly altering the basic issue presented here. See App. B, fns. 1, 2, p. 26.

[9] See, *e.g.*, 1954 Code § 932(c); Treas. Reg. §§ 1.901-2(e), 1.931-1(a), 1.957-3(b).

[10] Rev. Rul. 56-616, 1956-2 Cum. Bull. 589.

ritorial income tax by substituting "GUAM" for "United States" and omitting "inapplicable language." Organic Act of Guam § 31(e) (App. B, *infra*, p. 28). Section 881 imposes upon "every foreign corporation not engaged in trade or business within GUAM * * *, in lieu of the [regular corporate] taxes imposed by section 11, a tax of 30 per cent of" the gross dividends, interest, etc., received from domestic corporations.[11] A foreign corporation is one which is not "created or organized in GUAM or under the law of GUAM *or of any State or Territory*" (italics added). 1954 Code § 7701(a)(4), (5).

Since Guam has no States or Territories, we submit that the italicized phrase should be omitted as "inapplicable language." If this is done, the Guam tax will function like the United States tax. Since a Guam corporation is, for purposes of the United States income tax, considered a foreign corporation, a United States corporation should, for purposes of the Guam income tax, be considered a foreign corporation. If a Guam corporation not engaged in business in the United States owns all of the stock of a California corporation, the United States tax authorities will (1) treat the Guam parent as a foreign corporation, (2) collect a 50 per cent income tax on the net earnings of the California corporation under § 11, and (3) then collect a 30 per cent tax on the gross dividends from the domestic to the foreign (Guam) corporation under § 881, for a combined tax of approximately 65 per cent. Guam should be able

[11] The word "GUAM" indicates substitution in place of the words "United States."

to collect the same amount of tax where, as here, one of its domestic corporations pays dividends to a foreign (California) corporation.[12]

(b). The court of appeals, however, reasoned that Congress could not have intended Guam to collect more than 50 percent in total tax. It therefore held that the words "of any State" in the phrase "created or organized in GUAM or under the law of GUAM or of any State" were not "inapplicable language" but rather referred to any State of the United States, so that a corporation organized in a State of the United States is a domestic corporation for purposes of the Guam income tax.

The court of appeals reached this result because it could "find nothing to indicate that Congress intended" Guam to collect a cumulative tax of more than 50 percent on the same income (App. A, *infra*, p. 24). However, examination of the basic principles of the Code demonstrates that Congress clearly did intend the United States (or Guam) to collect taxes aggregating more than 50 percent when a corporation earns income and then pays its after-tax earnings to its stockholders as dividends.

[12] Since the rates of taxation of foreign corporations varies depending upon whether the foreign corporation is engaged in business in the United States, unless otherwise stated, when we discuss a Guam corporation which receives dividends from an American corporation, we are using the rates applicable where the Guamanian corporation is not engaged in business in the United States. Similarly, when we discuss an American corporation receiving payments from a Guam corporation, we assume that the former is not engaged in business in Guam.

If, for example, a United States corporation is wholly owned by one or more United States citizens, the domestic corporation pays 50 percent tax on its net income and, when it pays the after-tax earnings to its stockholders as dividends, they pay individual income taxes at rates up to 70 percent. Thus, the combined taxes from the two steps may total as much as 85 percent of the corporation's original earnings.[13]

If, as another example, a United States corporation is wholly owned by a foreign corporation which is not engaged in business in the United States, the domestic corporation pays the usual 50 percent corporate tax under § 11 and, when the domestic corporation pays the after-tax earnings to its foreign parent as a dividend, the parent pays a 30 percent tax under § 881 on the gross dividend. Thus, the combined United States tax on the domestic subsidiary and the foreign parent is approximately 65 percent.[14]

This is equally true where the foreign parent is a Guamanian corporation, since for purposes of the United States income tax Guam corporations are foreign corporations. Rev. Rul. 56–616, 1956–2 Cum. Bull. 589. Thus, if the facts of the instant case were

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[13] And State and local taxes may take an additional amount. The New York City and State corporate taxes, for example, amount to almost 11 percent of net income. Administrative Code of New York City, Title R, City Business Tax, §§ R. 46–3.0, R. 46–4.0, R. 46–20.0, as enacted by L.L. 21, Laws 1966 (CCH New York Tax Reporter, ¶¶ 193–306a, 193–307b, 193–346a) (5½ percent tax); Tax Law, 59 McKinney's Consolidated Laws of New York Annotated, c. 60, §§ 208–210 (5½ percent tax). The Guam tax here in question is comparable to both the federal and the local income taxes in this country.

[14] Tax treaties with approximately 25 foreign countries, mostly in Western Europe, have reduced the 30 percent tax to 15 percent or, in some cases, to 5 percent. 4CCH Standard Federal Tax Reporter (1967), ¶ 4206.05.

reversed, so that A.K. Guam was the parent corporation and A.K. California the wholly owned subsidiary, the United States would collect a combined tax of 65 percent on United States earnings paid as dividends to the Guamanian parent.

Moreover, this would also be true if the United States corporation was owned by one or more Guamanian citizens. The United States corporation would pay the usual 50 percent tax on its earnings and the Guamanian stockholders would be subject to the United States tax of 30 percent of the gross dividends paid to them by the United States corporation. 1954 Code § 871; Treas. Reg. § 1.932–1(a)(1). The combined tax paid by the United States corporation and its individual Guamanian stockholders would be 65 percent.

Thus it is clear that the scheme of the Code is generally to collect at least two taxes on corporate income—once when the income is earned by the corporation and once when it is paid to its stockholder or stockholders as a dividend, and it is not at all unusual for the combined tax to reach 65 percent. The fact that the stockholders are *foreign* corporations or citizens affects only the rate of tax imposed at the stockholder level (*i.e.*, whether a graduated tax on net income or a flat 30 percent tax on gross income) and the method of collection (*i.e.*, whether the tax is collected from the stockholder or withheld by the payor corporation), but not whether they are taxed.

(c). In applying the Internal Revenue Code to Guam, Congress adopted the same scheme of taxing corporate earnings once when earned and once when distributed. If a Guam corporation is owned by one or more Guam-

anian citizens, Guam collects two taxes which, depending on the individual shareholders' tax brackets, might total as much as 85 percent. However, if the same Guam corporation is owned by one or more United States corporations, the Ninth Circuit's decision apparently allows Guam to collect only one tax (*i.e.*, on the Guam corporation's earnings) and exempts the recipients of the dividends from Guam tax. Thus, Guam collects more tax when a Guam corporation is owned by Guamanians than when it is owned by a United States corporation or corporations.

As pointed out *supra*, if a Guam corporation has a United States subsidiary, the United States collects two taxes—one from the parent and one from the subsidiary—aggregating 65 percent. However, if a Guamanian subsidiary is owned by a United States corporation, the Ninth Circuit's decision results in Guam collecting only one tax of 50 percent. We submit that such a construction clearly violates Congress' clear intent to give Guam a separate, mirror income tax act that would operate within Guam in the same way that the Internal Revenue Code operates within the United States.

Moreover, notwithstanding the Ninth Circuit's decision, if a Guam corporation is owned by one or more individual United States citizens, Guam apparently collects two taxes aggregating 65 percent; it collects the usual 50 percent tax on the domestic corporation's earnings and then a 30 percent tax under § 871 when the corporate earnings are distributed as dividends to nonresident alien individuals (*i.e.*, United States

citizens resident in the United States).[15] Therefore, if a Guamanian corporation is wholly owned by a United States corporation, Guam collects only 50 percent tax under the instant decision, but if the Guam corporation is owned by a United States individual, Guam collects a combined tax of 65 percent. Moreover, if the stock of a Guam corporation were owned one-half by a United States corporation and one-half by an individual United States citizen, Guam would collect a combined tax of 50 percent on the corporate earnings distributed as dividends to the United States corporation and a combined tax of 65 percent on the corporate earnings distributed as dividends to the United States individual.

Finally, the logical consequence of the Ninth Circuit's decision is to preclude Guam from collecting any tax at all on interest, royalties, salaries, and most other payments by its corporations and citizens to United States corporations not engaged in business in Guam. The Ninth Circuit purported to restrict its holding that United States corporations are domestic for purposes of the Guam income tax to § 881. If this means that for other Code sections United States corporations are foreign, Guam apparently collects no tax at all on interest, royalties, salaries and most other forms of income paid to United States corporations by Guam corporations or citizens. Assume, for example, that a Guam corporation which has bor-

[15] Presumably a United States citizen resident in the United States would be a nonresident alien so far as Guam is concerned. A citizen of Guam resident in Guam is considered a nonresident alien so far as the United States is concerned. 1954 Code § 932; Rev. Rul. 56, 1953–1 Cum. Bull. 303.

rowed substantial amounts from a United States bank earns $100,000 before the payment of interest on the loan, and that the Guam corporation pays $100,000 of interest to the United States bank. The Guam corporation's taxable income would then be zero and it would owe no corporate tax to Guam. Moreover, under this interpretation of the instant decision, the United States bank, which has earned $100,000 from Guam sources, would apparently owe no tax to Guam. Thus, for all payments that are deductible to the payor—such as interest, royalties, salaries, and generally everything other than dividends—the instant decision does not merely reduce the Guam tax to 50 percent; instead, it apparently bars the collection of any Guam tax.

In short, the instant decision will create serious anomalies and complications in the administration of the Guam Territorial income tax and deprive Guam of significant revenue which the scheme of both the Internal Revenue Code and § 31 of the Organic Act of Guam indicate Congress intended it to have.[16]

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[16] In response to the court of appeals mandate and erroneously believing that the time for filing a petition for certiorari had expired, the Guam tax authorities have refunded the tax, with interest and costs. The refund was not made in settlement of the judgment below and the controversy between the parties is not moot. See *Dakota County* v. *Glidden*, 113 U.S. 222, 224; *Cahill* v. *New York, N.H. & H. R. Co.*, 351 U.S. 183; *United States* v. *Hougham*, 364 U.S. 310. If this Court grants the petition and ultimately reverses, Guam will take appropriate action to recover the tax erroneously refunded. 1954 Code § 7405(b); § 31(h)(4), Organic Act of Guam (48 U.S.C. 1421i (h)(4)) (authorizing Guam to bring suits for the recovery of erroneous tax refunds).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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